The Australian Journal of Agricultural and Resource Economics, 46:3, pp. 447–461

Australia as a branch office economy*

Ross Garnaut†

There has been a recent tendency for the location of executive leadership of companies engaged in natural resource-based production to shift from Australia to the Northern Hemisphere cities. What is the cause of this tendency? Does it matter to Australian welfare? If it matters, is there any action by Government that can weaken the tendency or reduce its negative effects?

Direct regulatory intervention to prevent relocation of corporate headquarters is unlikely to increase Australian welfare. However, reforms to reduce transport and telecommunications costs and to increase the attractions of residence in Australia of people with skills that are important in executive leadership would have positive effects.

1. Introduction

On the eve of ANZAC Day, 2001, the Australian Government exercised its powers under the Foreign Acquisition and Takeovers Act to prevent a European company, Shell, from acquiring a substantial shareholding in the Australian company Woodside Petroleum Limited. The acquisition, if it had been completed, would have resulted in a change of control of Woodside. The Treasurer in announcing his decision said that it was in the national interest for sales from the North West Shelf gas project to be promoted in preference to competing sales from projects in other parts of the world. By implication, the Treasurer judged that there was a risk that if Shell controlled the development of the North West Shelf, it may choose to promote sales from other parts of the world in preference to sales from Australia.

The Shell proposal was one of many over the past half-dozen years for foreign firms to take control of companies which have responsibility for development of commercially valuable natural resources in Australia. Over this period, the centre of effective executive leadership of the two largest mining countries in Australia, BHP and CRA, which were to become major parts of two of the three largest mining companies in the world, shifted from

* This paper was first presented at the 2002 Conference of the Australian Agricultural and Resource Economics Society (AARES), 13 February 2002, Canberra.

† Ross Garnaut, Professor of Economics, Research School of Pacific and Asian Studies, The Australian National University, Canberra.

Melbourne to London. There is current speculation that what had been the third largest mining company based in Australia, WMC, with its headquarters also in Melbourne, will soon be subject to takeover offers from firms based in one or other, or both, of the UK and the USA. North Ltd was absorbed into the London-based Rio Tinto at a time when it had the next largest market capitalisation after WMC among Australian mining companies. Executive control of what has been Australia's largest gold mining company, Normandy, in early 2002 shifted from Adelaide, South Australia, to Denver, Colorado.

The Australian Treasurer in the Woodside decision was reacting to the circumstances of the case before him, but also to more general anxiety in the community that Australia was in the process of transition to a branch office economy, in which relatively few senior executive leadership functions were undertaken in Australia. This was being felt most acutely in the natural resource-based industries in which Australian companies had played major leadership roles. Similar issues have arisen in the agricultural sector, for example in relation to grain, dairy products and wine.

The stronger tendency in recent times for Australian resources to come under the ownership and control of foreign companies has its origins in reductions of costs of international transactions, itself the driving force behind the phenomenon that is known as 'globalisation'. Does it matter to any Australians, other than those directly involved as shareholders and senior managers and members of Boards, whether the Australian resources sector is managed through branch offices of foreign enterprises? If it matters, is there anything within the influence of Australian Government policy that can influence the location of executive business leadership, at least partially, without doing more harm than good to the Australian national interest? Should we see the Woodside intervention as a mistake, or a model?

In this paper I move lightly over the issues, and use some naive theorising to suggest a few hypotheses. The paper suggests that these issues are important enough to be represented on the research agenda of the Australian agricultural and resource economics profession. That the issues are of importance beyond the resources sector should be no inhibition. Indeed, it would be in the tradition of agricultural and resource economics in Australia to work from an issue that had arisen in the resource sector, to conclusions that have significance for the wider national and international economies.

2. Globalisation and the Australian resources sector

There is nothing new about globalisation in the Australian economy, and the Australian resources sector in particular. Specialisation in production of a few resource-based products, principally gold and wool, the value of which was high enough in comparison to weight and therefore transport costs to

Europe, provided the base for Australia's relatively high standard of living in the nineteenth century (McLean and Maddock 1987). Much of the financial and human capital that was necessary at each new stage of the development of the mining and pastoral industries came from Europe. A high proportion of large businesses in the resource-based industries were owned and controlled from Europe.

Protection within the Australian Federation made economic activity generally less internationally-orientated through most of the twentieth century, but the mining and pastoral industries remained heavily export-orientated (Anderson and Garnaut 1987). Indeed, protection, by raising costs across the whole economy and destroying international competitiveness in industries in which Australia had positive but weak comparative advantage, increased the concentration of Australian exports in natural resource-based commodities. From the early years of Australian development, the accumulation of domestic savings and skills, and the advantages of locating the main centres of executive management close to natural resource-based production, saw the development of many substantial Australian-owned and controlled businesses in the natural resource-based industries. Some of these became large on a world scale.

Despite the effects of protection through the twentieth century, cost-reducing technological change in transport and communications gradually expanded the range of commodities based on Australian resources that could be exported profitably to the world's main centres of internationally-orientated consumption and industrial production. Grain, meat and dairy products and a few bulk mineral products which were in demand in nearby Asian centres joined wool and gold in the export lists. Through the second half of the twentieth century, Australia's economic isolation was reduced by the shift in the centre of gravity of world industrial production and consumption towards Australia with sustained industrialisation and economic growth in East Asia. Rapid East Asian growth also led to the emergence of new and bigger export industries based on natural resources, including for the first time large industries exporting such low value-to-weight commodities as coal, iron ore and bauxite.

There was an acceleration of the rate of technological progress in communications and transport leading to reduction in costs of international business transactions in the late twentieth century. These developments established the conditions for the deepening integration of global markets for goods, services, capital and to a lesser extent labour. The technological tendencies were reinforced in many countries by liberalisation of international trade and payments and deregulation of the service industries. In Australia, the unwinding of the high protection and controls on international payments late in the twentieth century meant that the increased integration

into global markets proceeded relatively rapidly. There was rapid expansion in direct investment both into and out of Australia after the abolition of exchange controls in 1983, and in the scale and diversity of exports through the period when protection was falling to low levels, between 1983 and the end of the century. (See Productivity Commission, 2002a for evidence on outward investment.) The increased foreign ownership of major businesses in the Australian resource sector over recent years is one dimension of the internationalisation of economic activity. The reduction in international transactions costs has reduced the disadvantages of distance in all its dimensions. The evidence that the roles of foreign-owned businesses in the Australian resource sector has increased, seems to suggest that the technological change has reduced the costs of overcoming distance between corporate head offices and the centres of resource production, more than it has reduced the costs of isolation from product and capital markets.

3. Location bias in the global economy

The reduction in international trade and transactions costs as well as official barriers to trade and investment has enhanced the profitability of resource-based production in Australia. 'Globalisation' has been favourable for expansion of production in, and has increased the rent value of, Australian natural resource-based industries. Some of the associated addition to the value of Australian economic activity has come from the use of professional services away from the farms and mines. Considerable economic value is added in service activities outside the corporate head offices. Developments in the resource-based industries generally have been favourable for the performance of the Australian economy, and for economic performance in states which are relatively well-endowed with natural resources (Western Australia and Queensland). This paper focuses not on the total economic activity associated with the commercial development of natural resources, but with that associated with the location of corporate executive leadership.

There is a perception that the contemporary developments in communications technologies are unfavourable to the location of high-value economic activity including corporate leadership in small and isolated parts of the world economy. This is an important point of discussion in New Zealand, Tasmania and South Australia, and has been part of the general Australian concern about the branch office economy. This perception has emerged from observation of the apparent realities rather than from *a priori* theorising. Casual theorising might have led to the view that the efficient computer and the new communications technologies would make high-value economic activity, based on scarce human capital, more footloose, allowing the people with the most valuable skills to live in places that were preferred for such

personal reasons as lifestyle. What are the possible sources of bias against Australia, or more generally small and relatively isolated economies, in decisions on the location of executive leadership in the natural resource-based industries?

The technological change that has underpinned the increased internationalisation of economic activity has raised the optimal scale of firms involved in production and sale of natural resource-based products. This seems to be the market-place reality, even though the new technologies have not systematically increased the optimal scale of activity in many other areas of the economy. There are, as a result, a smaller number of firms of substantial scale in the resources sector, and therefore a smaller number of centres of corporate leadership. This could help to explain why the number of corporate head offices in Australia has fallen. However, it cannot explain why there has been a reduction in the proportion of major resource companies with headquarters in Australia.

Location of corporate headquarters close to the main centres of resource-based production seems to have become less important in recent times. London is now the main home of the world's three largest companies in the sector, at a time when mining in Britain and nearby Europe has shrunk to negligible proportions. Denver has emerged as the headquarters of the world's largest gold-mining company at a time when gold mining is unimportant in Colorado (although the major gold-producing state of Nevada is adjacent to the west). While there has been a tendency for corporate leadership functions to move away from the centres of resource-based production, leadership of the production activities themselves, and often of associated marketing activities, have not been taken further from the natural resources. The shift of mining companies' headquarters to the Northern Hemisphere has often been accompanied by decentralisation of leadership of production closer to the natural resources, for example from Melbourne to Brisbane or Perth.

Are the externalities associated with agglomeration of business leadership in a particular location crucial to the tendency for headquarters of resources companies to shift from Australia to the major economies of the Northern Hemisphere?[1] They are obviously important. Land rents and a range of other costs are highest in the largest centres of global business leadership, and only the largest companies can justify economically the overhead costs of headquarters in these centres. If these were the only factors determining head office location, we might see a hierarchy of cities and enterprises, with the largest global businesses being based in the largest centres of business

[1] An anonymous referee has drawn attention to network externalities associated with location of corporate headquarters. All the associated skills for two head offices are worth more per firm than if there were just one. Four generate more value than two, etc.

leadership. While these considerations are important, the scale and agglomeration hypothesis leaves unexplained some important phenomena. One puzzle is why, between two businesses in the gold sector of similar size a few years ago, both with ambitions to be major players in the global gold industry, based in cities of not dissimilar size and both a long way from the world's main centres of business leadership, the one based in Denver was able to purchase with ease the one based in Adelaide, and so to become the world's largest gold producer. Is it important for corporate leadership functions to be based near major centres of use of resource-based commodities, or near major centres of commodity trade, or, more generally, near markets? Again, this would seem to be part but only part of the story. If it were the determining part, the disadvantage of Australia's location would be diminishing over time with the shift towards the East Asian hemisphere of the centre of gravity of world use and imports of industrial raw materials.

Is the supply of professional and managerial personnel a critical factor? The relevant skills are many, including the rare talents for effective leadership of large global businesses, the business education and experience of senior management, and a wide range of specialised business services, including among many others engineering, management consulting, metallurgical, marketing, financial, economic, legal and accounting. Many of these services are supplied most efficiently from external specialists rather than from within the firm. Some require support from research, and therefore effective access to high quality research institutions. Major institutions for graduate education and research grow symbiotically with and adjacent to the main cities of business leadership.

How does Australia fare in relation to the supply of professional personnel? People with skills that are relevant to global businesses tend to be highly mobile, so that the attraction of a country or city to newcomers, as well as the supply of indigenous skills, is important. Obviously small scale is a disadvantage, which is capable of being modified by factors affecting retention and attraction of professional and managerial personnel. The Australian education and research systems produce large numbers of people relative to population size with skills relevant to global leadership in the resource sector, and in recent years they have been available at relatively low cost. Australia's larger cities are attractive in lifestyle and cost of living, but isolation from the major centres of human civilisation in the Northern Hemisphere is seen as a disadvantage by many people. Official barriers to entry of skilled personnel into Australia are annoying and would seem to be capable of reform at low political cost, but as one of the small number of countries of large-scale immigration, Australia is at no disadvantage on this point of comparison against all but a few developed countries. The considerable flow of talented and well-educated young people from Asia

over the past two decades strengthens Australia's position. Taxation rates and structure comprise a major disadvantage for Australia relative to its main competitors for corporate leadership, including the UK and the USA, and in the East Asian Hemisphere, Hong Kong and Singapore. The recent prominent cases involving CRA, Woodside, BHP, North and Normandy, and WMC suggest an especially important role for the supply price of investment, with companies based in the UK and the USA seeming to have a substantially lower cost of capital. Companies based in the countries with the world's deepest, most flexible capital markets have their assets valued more highly than equivalent assets owned by companies domiciled elsewhere, and are therefore able to offer higher prices for the assets.

This seems to be the contemporary reality, but it is not at first sight obvious why it should be so. The financial markets are said to be the places where 'globalisation' has moved farthest and fastest; where information flows are most complete, most rapid and lowest in cost. When pressing the 'enter' key gives instant access to the electronic herd from any substantial city at any time of the day or night, why is it a large advantage for an enterprise to be located in one of the countries with the best developed capital markets? One caution needs to be introduced at this point. One cannot be sure that the currently superior access to capital by companies based in the UK and the USA is a long-term feature of the international economy. The current attention of securities denominated in United States dollars in particular may reflect an element of temporary overvaluation in foreign exchange, equities and debt markets. The 'bubble economy' in Japan in the late 1980s and early 1990s is instructive (OECD 1999). It is not obvious why there should be such large differences in costs of capital according to country of corporate location, or whether current differences will persist. But at this point in history location in the UK and the USA seems to contribute to a favourable cost of capital.

4. Does being a branch office economy matter?

Increased competition for ownership of Australian natural resources could be expected to raise the rent value of the resources. It makes the Australian resource-based industries more competitive relative to alternative suppliers and in the process expands Australian output. Increased economic activity would tend to raise Australian employment and incomes. If the increased competition were focused on shares in companies which own Australian resources, it would increase the wealth of Australians who own shares directly or through superannuation funds. These are all unambiguously favourable consequences for Australia of tendencies towards globalisation of corporate ownership, even when corporate executive leadership shifts away from

Australia. Are there other consequences that could work in the direction of lowering Australian benefits, perhaps exceeding the positive effects?

Three possibilities warrant consideration.

First, head office functions, and the purchases of services with which they are inevitably associated, are large economic activities in themselves, associated with exceptionally high value added per person employed in them. Taxation revenues from personal and corporate incomes deriving from the head office functions are considerable. Their loss is associated with a significant reduction in economic value to cities and countries in which they had been located.

Second, there are large community externalities associated with the employment of large numbers of professional people including many with high organisational leadership qualities. The major Melbourne-based resource companies contributed leadership to the Australian debate about economic policy, and to public administration (part-time through membership of advisory bodies and Commissions, and full-time in the major wars). They provided leadership for such professional and community organisations as the Academy of Technological Sciences, the Institute of International Affairs, the Economics Society, the Asia-related societies, and the Universities and specialist institutions for scientific and economic research. On retirement from executive employment in the resource sector, they provided executive and non-executive leadership to many other Australian businesses.

A third possible cost of the branch office economy would arise if a foreign company took different business decisions from one that was owned and controlled in Australia. There is inevitably bias towards purchase of professional services, and towards support of educational and research institutions, from near the head office. Less certain is the possibility of a foreign company taking decisions that lead to lower prices or output from Australian resource industries. This possibility is the basis of Australian Government intervention to protect Australian ownership of Woodside and the export monopoly of the Australian Wheat Board.

Even where there is no opportunity significantly to influence world prices of a commodity, there may be rents of favourable location that are in principle available for distribution between importers and favourably located exporters. If there were competition among both exporters and importers, the location rents would be disbursed through market processes. Monopoly at one or other end of the sales relationship introduces the possibility of shifting location rents towards the monopolistic party. Monopoly at both the importing and exporting ends leads to complex patterns of bargaining.

These issues were analysed for the Australia-Japan trade in mineral raw materials in the 1970s (Smith 1978). Japan at this time was overwhelmingly the main import market for steel-making raw materials in Northeast Asia. The Japanese steel mills purchased their raw materials cooperatively, and in

the absence of cooperation among Australian suppliers were in a position to gain a high proportion of the rents due to Australia's favourable location. This case, in which the rents of location were exceptionally important, has been transformed by the emergence of Korea, Taiwan and mainland China as major importers of iron ore and coking coal. Any surviving elements of monopoly in Northeast Asian purchases have been counterbalanced by increased concentration of ownership at the Australian end.

The case for the Wheat Board export monopoly would seem to depend on the presence of rents from Australia's favourable location as a supplier to some markets. The relatively small ratio of transport to total supply costs in the wheat trade reduces the potential importance of location rents. The considerable competition among East Asian importers of wheat reduces the importance of monopoly power on the purchasers' side. It seems unlikely that the opportunity for raising Australian export prices by excluding multinational firms from the trade outweighs the efficiency and income distribution costs of monopoly (Irving, Arney and Linder, Industries Assistance Commission 2000).

Concern about a different kind of distortion in the trade decision-making process lay behind the decision to block the takeover of Woodside. Here the concern was that a European company with the capacity to draw gas from a range of international sources may favour non-Australian supplies. By contrast, an Australian company with resources only in Australia would be certain to utilise the Australian resource if it were able to secure contracts for sales.

We would expect the European firm, concerned to maximise global profits, to draw gas from Australian reserves if Australia were the lowest cost source of supply, but not if Australian costs were higher. What is not clear is why the Australian firm would be expected to secure the sales contract if its costs were higher than the alternative sources.

The one circumstance in which a profit-maximising multinational firm might utilise higher-cost non-Australian ahead of Australian resources would arise if global demand were lumpy and markets were imperfectly competitive, if supply were profitable from both locations, and if the company owned a larger share of the non-Australian resource by a wide enough margin to compensate for lower unit profitability. Perhaps paradoxically, these conditions depend on the European firm owning a relatively small proportion of the Australian resource. It is not impossible that this circumstance could arise in reality. The presence of these conditions was not demonstrated in the Woodside case.

5. Can policy help?

The preceeding section suggests that it matters if Australia is only or mainly a branch office economy. It rarely would matter that foreign-owned companies

take business decisions that lead to less exports and lower prices for resource-based production in Australia. It is of greater importance that business leadership, and the purchase of high-value services with which it is associated, is a large and highly valuable economic activity in itself, and because it is associated with external benefits that can materially influence the quality of the economy, polity and society.

It matters, but can anything be done about it that does more good than harm?

Two kinds of policy intervention warrant consideration. One is regulatory; using Government powers to block the purchase of Australian assets and to protect Australian enterprises from foreign competition in other ways. The other is policy change to diminish the commercial disadvantages and enhance the commercial advantages of locating business leadership functions in Australia.

The regulatory interventions are in their nature conservative and defensive. They try to hold what has already been established in Australia. They are not helpful to building larger Australian-based companies of international importance. They are not completely successful even in their defensive aims, as regulation is formal in its requirements, and the locus of real business leadership can shift despite formal requirements to maintain the head office or the residence of specified senior office-holders in Australia.

And regulatory intervention comes at a cost. It may confer benefits on the holders of senior offices in the company at the time of the intervention. However, it reduces the value, according to their own assessments, of Australian shareholders' assets. By curtailing the opportunities eventually to sell business assets at a maximum price, regulatory intervention reduces the incentive for Australians to build new companies that may later be of interest to foreign buyers.

Decisions to use regulatory powers against foreign takeovers are invariably made in a highly charged political environment. Such circumstances are not conducive to careful assessment of the narrow conditions under which such intervention might confer net benefits on Australia.

Policy change to enhance the advantages and to moderate the disadvantages of business leadership in Australia is more promising. There is no prospect of established global companies with headquarters in the major business leadership centres of the Northern Hemisphere re-locating to Australia. The challenge is to provide a congenial environment for the growth of Australian companies into major global businesses while holding their business leadership functions in Australia.

Here the policy agenda is not very different to the reform agenda for improving Australian economic performance more generally.

Australia's disadvantage in building and holding business leadership activities derives from its small scale and isolation from the main centres of global economic activity in the Northern Hemisphere.

Economic distance can be reduced by improving and reducing the costs of international communications and transport. There has been considerable movement in these directions through economic reforms since the mid-1980s (Productivity Commission 2002). But there is still a large gap between best practice and the Australian reality, as revealed in recent public discussion of the regulatory framework and infrastructure affecting broadband telecommunications. The removal of most Australian protection has made a large contribution to reducing Australia's economic distance from the rest of the world. The removal of the remaining protection would add to the benefits.

The rest of the world's protection also increases economic distance from Australia. Australia is not a decisive influence on other countries' trade liberalisation decisions. But neither is it irrelevant to them. Effective trade diplomacy, made credible by commitment to trade liberalisation at home, had some influence on the favourable outcome in the Uruguay Round of trade negotiations. Closer to home, Australian diplomacy, including through the formation and development of the Asia Pacific Economic Cooperation, was helpful to the rapid reductions in protection in all substantial Western Pacific economies between the mid-1980s and the financial crisis of 1997–8. Australia's support in many ways was helpful to China's efforts to join the World Trade Organization, from the beginnings of discussion in 1986 to success in 2001. It is an additional benefit of support for trade liberalisation in Asia that it helps to sustain the strong economic growth in Australia's own region that itself has contributed to reduced relative isolation in the world economy (Garnaut 1996; Drysdale and Song 2000).

Economic size can only be changed substantially over long periods. But the difference in size between the Australia that would result from the consistent application over half a century of policies that were favourable to rapid growth in population and labour productivity, and from those that inhibited growth, would be large enough to affect perceptions of Australia as a location for business leadership. Markets anticipate future developments, and bring to account expectations of future change before they are current realities.

Even more important than growth outcomes, would be the effect that expectations of strong growth would have on perceptions of Australia as a favourable place for young, talented and ambitious people to build their careers and their lives. There is some circularity here between the conditions that are conducive to economic growth, and those that are conducive to making Australia attractive as a location for business leadership.

Among the particular impediments to Australia being an attractive location for global business leadership, two, including what preliminary analysis suggests is the most important of all, would seem to be amenable to Australian policy choice.

The most important of the impediments is the higher cost of capital for Australian companies, reflected most importantly in the higher stock exchange valuation of assets owned by USA and British companies. The abolition of exchange controls and easing of regulatory restrictions on direct foreign investment has reduced these costs, but foreigners' lack of familiarity with the Australian institutional environment remains important. Here the most effective remedy would seem to be adoption of the accounting standards (suitably reformed after Enron!), stock exchange listing rules and corporate regulation of the USA.

The adoption of USA rules and standards would look like the surrender of a degree of Australian sovereignty. To the extent that it was, it would be the surrender of sovereignty in an area that is unimportant to most Australians, to gain substantial enhancement of sovereignty in ways that matter a great deal to Australian living standards, and quality of life.

The second substantial opportunity to reduce impediments to location of business leadership in Australia relates to generation, retention and attraction of high quality professional and managerial personnel. The rates and structure of taxation on personal income is a weakness that in principle is easily remedied, although it is constrained politically by perceptions that reform would be inequitable to the distribution of after-tax incomes within Australia. The challenge to Australia's political leadership is to develop the acceptable, wider set of policies of which the reform of taxation on professional incomes could be part. On attraction of professional personnel, it would be helpful if there were decisive steps towards further liberalisation of immigration rules for people with good education and professional skills.

The domestic generation of professional skills depends on the quality of institutions for graduate education and research. The main weakness in the established structures derives from the Australian community's distaste for competitive processes.

Finally, we should recognise that Australia's prospects depend on the quality of private institutions as well as on policy. While the establishment of a stronger institutional base for high quality graduate education and research depends on the national policy environment, it depends even more on Australian institutions designing their internal structures to maximise value. Similarly, Australia's success in global business leadership can be facilitated by policy reform, but depends as well on the quality of private business organisation and effort. It is not obvious that the leaders of Australian graduate education and research institutions, and major businesses, have

made the best possible use of the advantages of the Australian environment. The advantages for business leadership include Australia's location on the edge of a region that contains a substantial proportion of the world's economically valuable natural resources, and in the East Asian hemisphere which continues to experience stronger economic growth than the rest of the world.

6. Would free trade agreements help?

It is currently fashionable to favour Australian entry into 'free trade areas' with limited numbers of other countries as a means of overcoming the disadvantages of small size, if not of isolation. There have been recent negotiations on a free trade agreement between Australia–New Zealand and the Association of Southeast Asian Nations. There are discussions of varying intensity currently under way with Singapore, Thailand, Japan and the USA. Would free trade areas with these or other countries strengthen Australia's role in international business leadership?

This is not the same question as whether free trade in Australia and its trading partners would help. Free trade definitely would help. The biggest gain would come from Australia's completion of the trade liberalisation that went a long way in the late twentieth century. Reductions in other countries' protection would add to the gains. But would the negotiation of bilateral or regional free trade agreements move Australia and its trading partners towards free trade?

Not necessarily. Probably not if the regional or bilateral partner did not represent a high proportion of Australia's potential foreign trade. And especially not if the arrangements did not remove all barriers to trade in goods and services among participating countries. A regional or bilateral free trade area retains barriers to trade with third-world countries. It therefore introduces the tensions associated with trade discrimination against third-world countries and increases transactions costs in all foreign trade through the need to monitor rules of origin. These problems of free trade areas could be avoided by Australia removing all of its own protection against all countries as it entered the limited free trade area, in which case the main gains would come from Australia's own trade liberalisation.

In relation to a free trade agreement with the USA, the potential gains from liberalisation of merchandise trade, beyond those deriving from Australia's own liberalisation, would be concentrated in the farm sector. The USA Congressional discussion has made it clear that substantial farm trade liberalisation is unlikely in the context of a bilateral free trade agreement with Australia (Capling 2001).

Clean, bilateral free trade in goods and services with the USA is unlikely. This has been recognised more clearly in recent times. In response, the focus

of advocates for a free trade area has shifted more strongly to the potential gains from integration of Australian and USA capital and labour markets within a free trade agreement.

This paper has argued that there are advantages for Australia in deeper integration into international markets for capital and professional personnel. In the case of capital, the advantages are especially large in relation to integration into the USA markets. Would policy change to produce these outcomes be more likely in the context of a free trade agreement with the USA?

Three points need to be made in response to this important question. First, the main policy changes to ease the flow of capital and professional personnel between Australia and the USA will occur in Australia. Second, to the extent that there was any possibility of reciprocal policy adjustment in the USA, progress could be made in harmonisation of capital and labour market regulation through negotiation of a bilateral Economic Agreement independently of negotiations on a conventional free trade area. Third, the political tensions in both countries that would be associated with attempts to negotiate an agreement for free trade in goods and services would complicate rather than facilitate harmonisation of policies for movement of capital and professional personnel.

7. The research agenda

A quick flight over the territory has, I hope, established that the location of business leadership is a significant issue, and a worthwhile focus for economic research.

Empirical research might confirm some hypotheses presented in this paper, and raise doubts about others. It would inform us about the scale of effects that seem to be of some importance.

Empirical research would undoubtedly reveal a differentiated picture. One hypothesis worth testing is that even with good policy in all areas, Australia would be the efficient location for relatively few of the largest global companies, but the natural focus of executive leadership for medium-sized companies specialising in production in Australia and nearby countries in Asia and the Southwest Pacific. Research is also likely to reveal benefits from Australia being an efficient location for some executive leadership functions that can be separated geographically from corporate headquarters.

Most importantly, I suspect that closer analysis of problems that Australians have recently talked about in relation to the branch office economy, would provide yet one more reason for completing internationally-orientated reforms, the partial progress on which did so much to raise Australian productivity in the last decade of the twentieth century (Garnaut 2001).

References

Anderson, K. and Garnaut, R. 1987, *Australian Protectionism: Extent, Causes and Effects*, Allen and Unwin, Sydney.

Capling, A. 2001, 'An Australian-United States free trade agreement?', *Policy, Organization and Society*, vol. 21(1), pp. 11–28.

Drysdale, P. and Song, L. 2000, *China's entry to the WTO: strategic issues and quantitative assessments*, Routledge, London.

Garnaut, R. 1996, *Open regionalism: an Asia Pacific contribution to the world trading system*, Institute of Southeast Asian Studies, Singapore, and Allen and Unwin, Sydney.

Garnaut, R. 2001, *Social democracy in Australia's Asian future*, Asia Pacific Press, Canberra.

Irving, M., Arney, J. and Linder, B. 2000, *National competition policy review of the Wheat Market Act 1989*, Canberra (distributed by Department of Agriculture, Fishery and Forestry).

McLean, I. and Maddock, R. (eds), 1987, *The Australian economy in the long run*, Cambridge University Press, Cambridge.

OECD, 1999, *Economic survey of Japan*, OECD, Paris.

Productivity Commission 2000a, *Offshore investment by Australian firms: survey evidence*, Commission Research paper, Aus Info, Canberra.

Productivity Commission 2000b, *Submission to the National Competition Policy Review of the Wheat Marketing Act, 1989*, Aus Info, Canberra.

Productivity Commission 2002, *Productivity growth in Australia: are we enjoying a miracle?*, paper presented by Dean Parhum to the 2002 Economic and Social Outlook Conference, Melbourne Institute, Melbourne.

Smith, B. 1978, 'Long-term contracts for the supply of raw materials', in J. G. Crawford and Saburo Okita (eds), *Raw Materials and Pacific Economic Integration*, Croom Helm, London.